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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

BERNHARD F. MANKO,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether, in a criminal case, the prosecutor and trial judge may engage in a secret *ex parte* conference if it is said to be limited to matters of "litigation tactics" – here a conference in which the government obtained a ruling allowing it to secure a tactical advantage by highlighting *damaging* testimony before the jury in rebuttal summation; and may they keep such a ruling secret from the defense until it is too late for it to counter the tactic by highlighting contrary *favorable* testimony?

2. Whether in a criminal tax case the trial judge must instruct the jury to evaluate a defendant's good faith defense under the *subjective* standard mandated by the Court in *Cheek v. United States* (*i.e.*, defendant's good faith belief, if credited, must be accepted even if the belief is considered unreasonable), when the prosecution improperly argues to the jury, contrary to the *Cheek* rule, that the defendant's good faith defense be rejected as unreasonable and inconsistent with an *objective* reasonable man test?

3. Whether the statutory requirements for an interest deduction set out in the Internal Revenue Code – *genuine debt and accrual of interest* – are sufficient for an interest deduction, which is the rule in the Fourth, Sixth, and Tenth Circuits, or whether an additional subjective requirement – *profit motive* – may be implied in the statute by judicial gloss in a criminal case as is now the anomalous rule in the Second Circuit?

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Bernhard F. Manko prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit.[1]

[1] Petitioner adopts the petition of his co-defendant Jon Edelman, submitted by his attorneys Williams & Connolly. There were no other parties to this case at any stage of the proceedings.

OPINION BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at 979 F.2d 900 (2d Cir. 1992). It is Appendix A to this Petition.

JURISDICTION

The October 9, 1992 judgment of the United States Court of Appeals for the Second Circuit affirmed petitioner Manko's judgment of criminal conviction dated December 5, 1991 (Appendix C). A petition for rehearing was denied by order dated December 4, 1992 (Appendix B). The mandate was stayed by the Court of Appeals on December 12, 1992 (Appendix D). This Court's jurisdiction rests upon 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The Fifth Amendment to the United States Constitution provides in pertinent part:

> No person shall . . . be deprived of life, liberty, or property, without due process of law . . .

The Sixth Amendment to the United States Constitution provides in pertinent part:

> In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial by an impartial jury . . . and to have the Assistance of Counsel for his defense.

26 U.S.C. § 7206 provides in pertinent part:

> Any person who -
>
> (1) Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; or

> (2) Willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim or document, . . .
>
> * * *
>
> shall be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation) or imprisoned not more than 3 years, or both, together with the costs of prosecution.

Section 163(a) of the Internal Revenue Code provides:

> There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

STATEMENT

This case was tried in the Southern District of New York before District Judge Mary Johnson Lowe and a jury. The basis for federal jurisdiction in the district court is 18 U.S.C. § 3231, which states:

> The district courts of the United States shall have original jurisdiction, exclusive of the courts of the States, of all offenses against the laws of the United States.

Petitioner Bernhard Fred Manko and his co-defendant Jon Edelman were indicted in February 1989 in the Southern District of New York. In May 1989, a superseding indictment charged Manko with 27 counts and Edelman with 28 counts of making and subscribing to false tax returns in violation of 26 U.S.C. § 7206(1), aiding and abetting the preparation of false returns

in violation of 26 U.S.C. § 7206(2), and conspiring to violate the tax laws and to defraud the United States in violation of 18 U.S.C. § 371.

Both defendants were convicted under each statute charged on various counts and on November 26, 1991, they each were sentenced to a total term of five years' imprisonment and fined $450,000. The judgments of conviction were entered on December 5, 1991, and notices of appeal were filed on December 4, 1991. After affirming petitioner's conviction, the Second Circuit Court of Appeals granted his motion to stay its mandate for 90 days pending this Court's ruling on the instant petition for a writ of certiorari. (Appendix D).[2]

Defendants' convictions were based on their management of syndicated limited partnerships (the "Partnerships") which in 1982 and 1983 financed the purchase of $51 billion in United States Treasury bills ("T-bills") through repurchase agreements ("repos") that gave rise to interest expense deductions of $532 million. The government has viewed this case as the largest tax fraud prosecution ever brought. This is perhaps why it employed tactics not heretofore considered acceptable and why it sought to base its case on a tax law theory not universally accepted by the circuit courts.

The superseding indictment charged essentially that the repo transactions between two companies that defendants managed, Government Clearing Company and Government Securities Trading Corporation (collectively "GCC"), and a counter-party, TSM Holdings Inc. ("TSMH"), were "pre-arranged, rigged and fraudulent". According to the indictment:

> [I]n these fraudulent transactions, there were secret oral agreements with certain [co-]conspirators at TSM[H], not reflected in the trading confirmations, that [GCC] would make no money on the transactions and that the colluding entity, TSM[H], would

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[2] Relevant excerpts from the Southern District Court Record are reproduced in Appendix E.

> be paid a fee disguised as interest expense and built into the interest rate for the transactions.

(J.A. 20).[3]

There were two key issues of fact at trial: (1) whether the financing transactions (repos) actually took place; and (2) whether petitioners held a good faith belief that their actions were lawful. The key issue of law was whether the repos gave rise to lawful interest expense deductions under Section 163 of the Internal Revenue Code.[4] IRC § 163(a) (1988).

After a general verdict of guilty was returned by the jury, and in an effort to immunize the general verdict from attack, the district court gave the jury an unusual special interrogatory. The Court of Appeals relied heavily upon the jury's response which purportedly found that the repo transactions were fictitious or did not take place. (J.A. 481).

The special interrogatory should not inhibit this Court's issuance of a writ of certiorari because the interrogatory could not cure the defective general verdict. It did not produce findings necessary and sufficient for a conviction and it was answered

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[3] "J.A. ____" refers to the Second Circuit Joint Appendix; "R. ____" refers to the Southern District Court Record; and "T. ____" refers to the trial transcript.

[4] The Partnerships were formed during the period 1978 through 1983 when syndicated tax shelters proliferated. In 1981, Congress enacted the Economic Recovery Tax Act of 1981 ("ERTA"), Pub. L. 97-34 (1981), which eliminated the tax benefits associated with certain types of low-risk "straddles" transactions. ERTA eliminated the possibility of deferring income by requiring taxpayers to account for both the income and loss legs of a straddle as one integrated transaction in the same tax year. While ERTA eliminated specific shelter transactions, experts believed that the ERTA anti-straddle rules were likely to cause a dramatic increase in the popularity of another sheltering device commonly referred to as a "T-bill Roll." James W. Wetzler, "The Tax Treatment of Securities Transactions Under the Tax Reform Act of 1984," *Tax Notes, Special Report* (Oct. 29, 1984) (noting significant growth in use of leveraged T-bills to achieve tax deferral after ERTA passed in 1981); Lee A. Sheppard, "Economic Substance and the Case of T-bill Rolls," *Tax Notes* (July 23, 1990). The criminal charges in this case resulted from the Partnerships' use of the "T-bill Roll" as an alternative tax-advantaged trading strategy.

without proper judicial guidance on the law of contract formation. For example, the special interrogatory did not address the good faith defense with respect to the transactions, a defense the jury may have sustained if it was properly instructed. Similarly, it is likely that this finding was influenced by the tactical advantage secured by the government in an admittedly improper *ex parte* conference, as well as the government's improper argumentation, and the district court's failure to instruct the jury on the law appropriate to determine whether a contract is formed and a transaction has "taken place".[5]

The Secret Ex Parte Conference

The prosecution sought and obtained a secret *ex parte* conference with the trial judge and secured an advisory opinion allowing the use in rebuttal summation of several towering charts (larger than a person) containing 28 purported paraphrases and quotations of the record. Although a portion of the conference was transcribed (Appendix A-17-18), the sealed pages of what on its face appears to be an incomplete transcription were not disclosed until after the trial. The charts previewed in the meeting highlighted damaging out-of-context testimony

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[5] Among other things, the defense argued that if the recollection of witnesses with respect to ten year old negotiations of Treasury Bill transactions was not sufficient to establish the formation of a contract, the jury could still find contract formation based on the doctrine of ratification, *i.e.*, if trade confirmations were sent, received and not repudiated by the counter-parties, those counter-parties were bound. N.Y. U.C.C. § 8-319(c) (McKinney 1992). Paying only lip service to the rule that a defendant is entitled to a jury instruction explaining the defense theory (*see, e.g., United States v. GAF Corp.*, 928 F.2d 1253, 1262 (2d Cir. 1991)), the district court merely advised the jury that the defense contended that the transactions were "ratified". It refused to tell the jury what the term "ratified" meant and the legal requirements of the doctrine of ratification. The Court of Appeals erroneously sustained petitioner's criminal conviction on the ground that the jury charge proposed by defendants improperly set out the law of ratification (Appendix A-21-22); but the court misapprehended the law by overlooking N.Y. U.C.C. § 3-819(c) and relying *sua sponte* on inapplicable law not addressed by the parties. *Compare* N.Y. U.C.C. § 3-819(a) (McKinney 1992) (involving authority of agents and not principal-to-principal transactions); *Western Assocs., Inc. v. Niagara Props., Inc.*, 130 A.D.2d 964, 516 N.Y.S.2d 381 (4th Dep't 1987).

concerning the issue posed by the special interrogatory, *i.e.*, whether the financing transactions (repos) actually took place. Tactics can have a profound affect on a jury. To assume, as did the Second Circuit, that this tactic had no affect on the jury imperils the right to assistance of counsel and is simply unrealistic.

This admittedly improper and unnecessary *ex parte* conference occurred before defendants' summations and without their knowledge. Moreover, when the prosecutors solicited the district court's views on whether to give defendants notice of their intended use of the imposing charts the district judge clearly demonstrated her favoritism by responding: "I don't think you should disclose it." (Appendix E-6). With respect to several other incidents the Second Circuit found the district court's conduct "disturbing" and expressed "grave concern" at its "breach of impartiality". (Appendix A-15-17). The court then sealed the transcript of the *ex parte* conference and refused to unseal it until over a month after the trial had ended and then only upon the prosecution's consent. (Appendix E-7-8; R. 56). Such conduct, not heretofore sanctioned by this Court, is now protected by a safe harbor rule in the Second Circuit, placing it in direct conflict with the Sixth Circuit.

Defense counsel only discovered the *ex parte* conference when, in the middle of defense summations, they received a copy of the transcript indicating that two missing pages were sealed. (Appendix E-7-8). They immediately moved to unseal those pages, but the lower court denied the motion and refused to reveal the purpose of the conference stating "[t]he prejudice you will suffer will not be caused by what is sealed, all right?" (Appendix E-8). Defense counsel learned of the previewed charts for the first time on the next day during a 45-minute break immediately before the prosecution began rebuttal summation. Due to the short notice, defense counsel had only one and a half minutes to review each of the 28 excerpts taken from over 6,000 pages of transcript; first to verify their accuracy and fair context and then to ascertain whether each was within the proper scope of rebuttal.

It cannot be denied that these charts had an impact on the jury. For example, several of the enlarged excerpts went to the

heart of the special interrogatory. One purported paraphrase enlarged on a chart and read to the jury in rebuttal was a highly-charged, prejudicial and misleading statement of testimony by a trader involved in the transactions as follows: "Don't even show me those tickets, I don't want to be hauled out of here in handcuffs." (Appendix E-1; Appendix E-11-12). Defense counsel, if they were present in the *ex parte*, would have argued that the court, in its supervisory powers, should not allow this sentence to be blown-up for rebuttal because it was not a full and proper paraphrase. As to the tickets and the remark about "handcuffs", the trader testified later on cross-examination that the comment was not to communicate a serious message, rather it was "to rattle Joe Bryant's cage"; *and he did not even know whether the tickets referred to had anything to do with this case.* (Appendix E-2). It is clear that highlighting the quote without the full context and explanation (which may not have been in the jury's ready recall after a four month trial) had a strong impact on the jury.

Because the impact of the charts on the jury was palpably and predictably devastating, the defendants requested remedial relief in the form of a surrebuttal to put the charts' excerpts in their proper context. The district court rejected this request and ignored defendants' objections as to scope and use of the charts. The defense was thus unable to counter the tactical advantage improperly obtained by the prosecution. (J.A. 1550-53).

Failure to Charge Cheek

Defendants requested that the district court give the following charge based on this Court's opinion in *Cheek v. United States*, 111 S. Ct. 604 (1991):

> If you find that the defendant you are considering believed that the repo interest expense arising from the transactions at issue in this case was deductible under the Internal Revenue laws, he cannot be guilty of the charges in the indictment, *regardless of whether his belief was reasonable.*

(Appendix E-15) (Specific Criminal Intent). The district court rejected defendants' proposed charge, even though the prosecution consented to include the above-italicized language. (Appendix E-3).

The prosecution's summations took full advantage of the district court's refusal to give defendants' proposed instructions by arguing that defendants' beliefs were not reasonable, knowing the district court would not give a corrective charge. It thus completed an end run around this Court's decision in *Cheek*. During summations, the prosecution repeatedly urged the jury to hold defendants to an improper reasonable man standard, improperly asking them to measure defendants' good faith belief that the repo interest expense was deductible against what a reasonable businessman would have believed under the circumstances. ("You [the jury] constantly have to ask yourself against these facts, do real business men and women operate this way?" (Appendix E-5). "Is this the way real businessmen act, million dollar transactions, billion dollar transactions, no one knowing what is going on . . . ." (Appendix E-9).

In summation the government also suggested that the jury should reject the defendants' subjective belief as unreasonable by stating: "It only happens in the Manko world, in the land of Edelman. That is the only place it happens." (Appendix E-4). The government argued, in a fashion directly contrary to *Cheek*, that the jury should ask: "Where in the real world does that happen?" (Appendix E-4). Finally, the government ended its summation with an analogy everyone knows and which left no question that it was arguing that the defendants' subjective good faith belief should be rejected as unreasonable. The government charged: "Mr. Manko, Mr. Edelman, the emperor has no clothes." (Appendix E-7).

The prosecution suggested that the jury use its own experience to determine if defendants' good faith belief was reasonable. *See* Appendix E-3-4; J.A. 1491-95. On rebuttal summation, the prosecution suggested that in deliberations the jury divide itself into two groups and reenact its version of the facts. (Appendix E10). It prefaced this suggestion with the statement: "If it's legal

to do what the defendants did, you, ladies and gentlemen, can eliminate the tax liability of our entire country, and you can do it like that." (J.A. 1601). The defense alerted the trial court at the charging conference to the prosecutor's improper arguments to the jury suggesting that the jury apply an objective reasonable man test in deciding whether the petitioners' defense of good faith was well founded. (J.A. 331-334). The court refused to remedy the problem by instructing the rule of *Cheek*.

In *Cheek* this Court flatly held that it was improper for a jury in a criminal tax case to be instructed that the good faith defense be measured by an objective reasonable man standard because in the complex world of taxes, a subjective standard is appropriate. In this case, the district court did not distinguish between the objective and subjective standards. The Court of Appeals' affirmance endorsed the government's end run around *Cheek* by sustaining the convictions here despite the prosecutor's summation urging the jury to apply an objective standard while the district court remained silent on the issue and refused to issue a corrective instruction.

The Erroneous Interest Deduction Standard

Two weeks before the trial of this case, the Second Circuit decided *Jacobson v. Commissioner* which held that the only required elements for an interest expense deduction are actual debt and the payment or accrual of interest. 915 F.2d 832 (2d Cir. 1990). Since the issue was critically important and would determine trial strategy, the district court ruled just before opening arguments that it would follow *Jacobson*. (J.A. 488-89). *See* J.A. 1256-58. *After the parties rested*, the district court reversed this pretrial ruling.[6] It ruled that to find lawful interest

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[6] It is difficult to imagine a more certain basis for prejudice than the district court's "last minute 180-degree turn" in its announced treatment of a central issue in the case. *United States v. Mendel*, 746 F.2d 155, 161 (2d Cir. 1984), *cert. denied*, 469 U.S. 1213 (1985). Defendants went to trial and rested in reasonable reliance on the false understanding that the two-pronged economic substance test would not determine the outcome; "[i]t is not too much to say that [defense] counsel [were] seduced by the court's first ruling into forgoing submission of evidence" of profit potential and market risk. *Id.*

deductions the jury not only would have to find genuine debt and the payment or accrual of interest, but was also required to find that the transaction had "economic substance" which the court ambiguously defined two ways: (1) as requiring "a reasonable possibility of profit apart from tax deductions" or "market risk", and (2) "business purpose" or "market risk". (J.A. 413-14). *See generally* T. 1165-71; J.A. 454-63.

In affirming, the Second Circuit set out a rule which conflicts with the Fourth, Sixth, and Tenth Circuits.

REASONS FOR GRANTING THE WRIT

I

THE COURT OF APPEALS DECISION CREATES A CONFLICT IN THE CIRCUITS ON AN ISSUE WHICH HAS AN IMPORTANT IMPACT ON THE RIGHT TO ASSISTANCE OF COUNSEL AND WHICH SHOULD BE ADDRESSED BY THIS COURT WITHOUT DELAY

The Court of Appeals improperly applied a harmless error analysis in holding that the *ex parte* meeting between the judge and the prosecutor did not constitute reversible error. In doing so it sanctioned reprehensible conduct and created a conflict between the Second and Sixth Circuits on the circumstances in which *ex parte* conferences between the court and the government can be conducted with impunity in criminal cases. Should the Second Circuit rule announced in this case be allowed to stand, the government in a criminal case will be able to immunize *ex parte* conferences by determining with the court that they are "merely" tactical or administrative despite the fact that the defense is handicapped.

Although acknowledging that "the prosecution initiated this *ex parte* proceeding in a blatant attempt to win a tactical

advantage, to get a 'leg up' ", in its rebuttal summation, the Court of Appeals held that "this highly improper *ex parte* conference does not constitute reversible error." (Appendix A-19-20). This application of the harmless error doctrine is a radical departure from the standards governing constitutional error established by this Court. It establishes a safe harbor rule which will allow prosecutors and judges to collaborate on the use of tactics to maximize the chances of conviction. This rule will surely erode confidence in the impartiality of our judicial system.

This Court "has uniformly found constitutional error without any showing of prejudice when counsel was either totally absent, or prevented from assisting the accused during a critical stage of the proceeding." *United States v. Cronic*, 466 U.S. 648, 659 n.25 (1984) (collecting cases). There can be no doubt that the tactical advantage gained by the prosecutor's *ex parte* conference occurred at a critical stage of the trial because, as the Second Circuit found, it gave the prosecutor a tactical advantage in his rebuttal summation. *United States v. Swanson*, 943 F.2d 1070, 1074 (9th Cir. 1991) (summation is a "critical stage" of a criminal proceeding). This alone establishes prejudice. This Court, recognizing the importance of summation to a criminal defendant, has stated:

> The very premise of our adversary system of criminal justice is that partisan advocacy on both sides of a case will best promote the ultimate objective that the guilty be convicted and the innocent go free. In a criminal trial, which is in the end basically a factfinding process, no aspect of such advocacy could be more important than the opportunity finally to marshal the evidence for each side before submission of the case to judgment.

Herring v. New York, 422 U.S. 853, 862 (1975). The impact of argument on juror's minds is exaggerated where it is made in

a prosecutor's final summation.[7] *United States v. Solivan*, 937 F.2d 1146 (6th Cir. 1991).

The Second Circuit correctly observed that "the propriety of using the chart cannot be the measure of whether the *ex parte* proceeding constituted reversible error. Otherwise, the fact of an *ex parte* proceeding would be irrelevant so long as the court ultimately made the right ruling." (Appendix A-20). But it went on anyway to say that the first of two "facts" convincing it that reversal was not required was that it did not believe "the district court *would* [as opposed to *could*] have ruled differently absent the *ex parte* conference." (Appendix A-20) (emphasis added). Quite clearly, with the benefit of defense counsels' advocacy, the district court *could* have correctly ruled differently in any one of several favorable ways as follows:

1. The quotes and paraphrases used in the prosecution's charts would have to be put in proper context by the prosecution (*i.e.*, a fair context rule);

2. The prosecution could use charts in rebuttal summation, but the defense would be entitled to surrebutal to put the quotes and paraphrases in their proper context;

3. No charts could be used by the prosecution in rebuttal unless first used in its closing – so defendants could use their closing to put the quotes in proper context;

4. The charts could not be as large as those used by the prosecution;

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[7] The devastating impact of charts used in summation is attested to by the many trial manuals and treatises advocating their use. *See, e.g.*, F. Lee Bailey & Henry B. Rothblatt, *Successful Techniques for Criminal Trials* § 24:11 at 544-45 (2d ed. 1985); 5 Melvin M. Belli, Sr., *Modern Trials* 69-120, 439-43 (2d ed. 1982); Jacob A. Stein, *Closing Argument* §§ 206-07 (1985); Albert H. Parnell, "The Effective Use of Demonstrative Aids in Closing Argument", *For the Defense* 15-20 (Dec. 1983). This is particularly the case with jurors who had listened to hundreds of hours of testimony on complex financial transactions during four months of trial. It is difficult to fathom how the jury could not be swayed by highlighted, charged testimony in last-word rebuttal where the context could not be clearly, if at all, remembered.

5. No charts could be used by either side; or

6. Both the prosecution and the defense would be permitted to use charts.

The Second Circuit applied harmless error analysis to the *ex parte* conference despite the fact that it gave the prosecution a "tactical advantage" at a critical stage of this criminal trial. (Appendix A-19). That holding violated this Court's ruling in *Cronic* that such deprivation of the right to assistance of counsel is *per se* reversible error without any showing of prejudice.

A more appropriate solution to the problem of *ex parte* conferences was presented recently in *United States v. Minsky*, 963 F.2d 870 (6th Cir. 1992), where, in conflict with the Second Circuit's affirmance in this case, the court held that such an *ex parte* conference at a *critical stage* was sufficient ground for reversal *standing alone*, and indicated that it would reverse the judgment below *before* it decided whether the *ex parte* ruling was substantively correct. The *Minsky* analysis is correct because its decision to reverse based on the *ex parte* conference was made *prior to* a consideration of the propriety of the *ex parte* ruling itself. Otherwise a prosecutor need only secure a non-erroneous *ex parte* ruling (though one of many possible non-erroneous rulings) to safely gain a tactical advantage. The decision of the Sixth Circuit was based on the principle that a court should "refuse to condone conduct that 'undermines confidence in the impartiality of the court'". *Id.* at 874 (citation omitted). The Second Circuit condoned just such conduct in this case.

The panel's opinion will encourage rather than discourage the use of *ex parte* conferences by effectively establishing a safe harbor rule that may be stated most narrowly as follows:

> *SAFE HARBOR RULE*: It is not reversible error for the prosecutor and trial judge to have a secret, *ex parte* conference so the prosecutor can secure a tactical advantage or a "leg-up". *EXPLANATION*: Although it is improper to engage in such conduct, it is not reversible error unless the defendant can overcome the

> harmless error rule. *EXAMPLE*: It is not reversible error if the tactical advantage allows the prosecutor to highlight damaging testimony or paraphrases of testimony in its last-word rebuttal summation because successfully highlighting damaging testimony on the ultimate factual issue of a case cannot, as a matter of law, have even a minimal effect on the jury.

See Appendix A-19. This safe harbor rule sends a dangerous message to prosecutors and is in conflict with this Court's ruling in *Cronic* as well as with the Sixth Circuit's decision in *Minsky*. If the Second Circuit's tolerance of *ex parte* conferences is not forcefully rejected, the integrity of our judicial system will be damaged.

II

THE DECISION OF THE COURT BELOW CONFLICTS WITH THIS COURT'S HOLDING IN *CHEEK* THAT A DEFENDANT'S GOOD FAITH DEFENSE IS TO BE MEASURED BY A SUBJECTIVE TEST

Petitioner was convicted of criminal tax violations of 26 U.S.C. § 7206(1) that require a finding of specific intent. *United States v. Gurary*, 860 F.2d 521, 523 (2d Cir. 1988), *cert. denied*, 490 U.S. 1035 (1989). To be guilty of violating a known legal duty, by making and subscribing false tax returns in violation of 26 U.S.C. § 7206(1), and of "willfully" aiding and assisting in the preparation of a false tax return in violation of 26 U.S.C. § 7206(2), a person must *intentionally* violate a known legal duty. *United States v. Pomponio*, 429 U.S. 10, 11 (1976); *United States v. Golitschek*, 808 F.2d 195, 202-03 (2d Cir. 1986). Yet, petitioner's conviction was upheld on appeal despite the fact that the trial court failed to properly instruct that the jury must determine the validity of a defense of good faith based on what petitioner honestly believed.

A. *Cheek* Established A Rule Of Subjective Good Faith.

This Court has held that in criminal cases involving violations of federal tax law, a jury's determination of whether a

proper defense of good faith has been established is to be determined by reference to the subjective belief of the accused. *Cheek*, 111 S. Ct. at 604. In *Cheek*, this Court specifically announced that a defendant's belief need not be objectively reasonable in order to support a defense of good faith. *Id.* at 611.

As this Court explained in *Cheek*:

> In the end, the issue is whether, based on all the evidence, the Government has proved that the defendant was aware of the duty at issue, which cannot be true if the jury credits a good faith misunderstanding and belief submission, *whether or not* the claimed belief or misunderstanding is objectively reasonable.

Id. (emphasis added). The *Cheek* rule emerged out of a recognition that "[t]he proliferation of statutes and regulations has sometimes made it difficult . . . to know and comprehend . . . the tax laws." *Id.* at 609. This Court recognized in *Cheek* that Congress intended to exclude honest mistakes by making specific intent an element of federal tax crimes:

> "[I]n our complex tax system, uncertainty often arises even among taxpayers who earnestly wish to follow the law" and ". . . it is not the purpose of the law to penalize frank difference of opinion or innocent errors made despite the exercise of reasonable care."

Id. at 612 (*quoting United States v. Bishop*, 412 U.S. 346, 360-361 (1973)). More than statutory construction, this is a matter of constitutional importance because, "forbidding the jury to consider evidence that might negate willfulness would raise a serious question under the Sixth Amendment's jury trial provision." *Id.* at 611 (citations omitted).

Under *Cheek*, the jury is precluded from substituting its own determination of objective reasonableness for what the defendant subjectively believed. *See, e.g., United States v. Powell*, 955 F.2d 1206, 1211-12 (9th Cir. 1992). Even if the evidence against a defendant is strong, an erroneous instruction suggesting that an objective standard applies is plain error. *United States v. Aitken*, 755 F.2d 188, 193-94 (1st Cir. 1985).

The trial court below denied petitioner's requested charge regarding its defense of good faith and refused to inform the jury that it is the defendants' subjective belief that controls. *See* J.A. 375. Specifically, the trial court refused to charge the jury that a good faith belief in the legality of tax deductions negates the specific intent necessary to support a criminal conviction *regardless of whether that belief was reasonable.* (Appendix E-13-15).

The charge given by the trial court included the following general language: "A person who believes that his tax return truthfully reports the taxable income and allowable deductions under the tax law acts in good faith and cannot be found guilty of wilfully filing a false return." (Appendix E-13). The instruction omitted the pivotal concept announced in *Cheek* that a good faith defense is not negated by a finding that the defendants' belief may have been objectively unreasonable. (Appendix E-13). The vague instruction given was insufficient after the prosecution had repeatedly argued to the jury that it should convict based on a finding that the defendants' belief in the legality of the transactions was unreasonable.

B. The Prosecutors' Arguments In Summation Allowed The Government To Circumvent The Rule Announced In *Cheek* Mandating A Subjective Test.

1. Prosecution May Not Argue Incorrect Statements Of The Law

This Court has held that a prosecutor may not make improper suggestions, insinuations or assertions to a jury, calculated to mislead. *Berger v. United States*, 295 U.S. 78 (1935); *United States v. Young*, 470 U.S. 1, 7 (1984) ("Nearly half a century ago this Court counselled prosecutors 'to refrain from improper methods calculated to produce a wrongful conviction . . .' " (*quoting Berger*, 295 U.S. at 88)); *United States v. Corona*, 551 F.2d 1386 (5th Cir. 1977). Nor may the prosecution argue incorrect or inapplicable theories of law to the jury. *United States v. Wheeler*, 800 F.2d 100, 106-07 (7th Cir. 1987) (prosecution's arguments which effectively shifted its legal burden of proof

were improper); *Mahorney v. Wallman*, 917 F.2d 469, 470-74 (10th Cir. 1990) (prosecution's arguments incorrectly describing the presumption of innocence found to be reversible error). *See United States v. Hammond*, 642 F.2d 248, 249-50 (2d Cir. 1981); *Graham v. United States*, 257 F.2d 724 (6th Cir. 1958).

These rules are required because jurors should be confident that the prosecuting attorney will not use improper methods calculated to produce a wrongful conviction. *Berger*, 295 U.S. at 88. Consequently, improper suggestions, insinuations and assertions made by the prosecution are apt to carry much weight against the accused when they should properly carry none. *Id.*

Thus, a prosecutor's argument to the jury carries with it the imprimatur of the government and may induce the jury to trust the government's judgment rather than its own. *Young*, 470 U.S. at 18; *Tarpley v. Dugger*, 841 F.2d 359 (11th Cir.), *cert. denied*, 488 U.S. 837 (1988); *Hall v. United States*, 419 F.2d 582 (5th Cir. 1969). When prosecutors abuse this mantle of authority, it unfairly plays upon the jury's susceptibility to credit the prosecutor's viewpoint. *Brooks v. Kemp*, 762 F.2d 1383, 1399, 1410 (11th Cir. 1985), *cert. granted, judgment vacated on other grounds*, 478 U.S. 1016 (1986), *on remand, judgment reinstated*, 809 F.2d 700 (11th Cir.), *cert. denied*, 483 U.S. 1010 (1987).

The district court had an obligation to correct the false impression left by the prosecution but failed to do so. *See Young*, 470 U.S. at 9-10; *United States v. Pabisz*, 936 F.2d 80, 83 (2d Cir. 1991); *GAF*, 928 F.2d at 1263 n.4.

2. The Prosecution's Arguments To The Jury Circumvented The Rule Of *Cheek*

The jury was misled as to the test to apply in determining the validity of petitioner's good faith defense by the prosecution's arguments. As a result, the prosecution's burden of establishing the petitioner's specific criminal intent to violate a known legal duty beyond a reasonable doubt was effectively removed.

During summation, the prosecutor invited the jury to use an objective test when he stated: "Would any businessman or businesswoman act the way these guys did?" (Appendix E-5)... "It only happens in the Manko world, in the land of Edelman. That is the only place it happens." (Appendix E-4). And later, the prosecutor asked: "Is this the way real businessmen act, million dollar transactions, billion dollar transactions, no one knowing what is going on, supposedly at risk, having $33 in cash?" (Appendix E-9). The government thus asked the jury to measure the defendants' conduct by what it argued objective "real businessmen" would believe or do under the circumstances.

Moreover, after describing the defendants as selling tax losses and inviting the jury to simulate the activities of the petitioners during the jury's deliberation, the government concluded:

> Ladies and gentlemen, if you really think you can do that, then acquit the defendants. You should acquit the defendants *if you think you can do that*. But if you think what I just suggested is absolutely ridiculous, and the defendants know that, then it's your duty to convict them.

(Appendix E-10) (emphasis supplied). The government's clear invitation to the jury to substitute its own beliefs about the transactions at issue for that of the defendants eviscerated the defense of good faith. This erroneous suggestion cried out for correction by the trial court. Yet, the court permitted this misleading argument over the defense's objection. (Appendix E-10). The court's refusal to correct the prosecutor's misstatements when requested to do so gave the prosecution's arguments the appearance of judicial approval. *See Mahorney*, 917 F.2d at 473 n.4.

When viewed through the distorting lens of the prosecution's misleading arguments, the charge did not make clear to the jury that the defendants must demonstrate only that a subjective good faith belief in the legality of the acts was held and not that the belief must be found to be objectively reasonable.[8] The

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[8] There was ample evidence adduced at trial of the petitioners' good faith belief in the legality of the transactions (J.A. 1329-34, 1343, 1348, 1350-55) and the reasons for their belief (J.A. 1108, 1116, 1143, 1266-71).

government should not be permitted to so circumvent the holding of this Court in *Cheek*.

III

THE DECISIONS BELOW ARE IN CONFLICT WITH THE LAW IN OTHER CIRCUITS CONCERNING THE REQUIREMENTS FOR AN INTEREST DEDUCTION

The critical legal issue in the trial of this case concerned the requirements for an interest deduction under Section 163(a) of the Internal Revenue Code (the "Code"). The rules for interest deductibility are important and need to be clearly spelled out. Deductibility of interest on indebtedness affects the cost of borrowing and, therefore, the pace and scope of commercial activity in our debt markets which are vast in volume and value. The imposition of criminal sanctions in an interest deduction case when the law is confused and the circuits are in conflict requires that this Court articulate a clear rule. If this confusion and conflict are not resolved by this Court, it will result in inconsistent treatment of taxpayers, both civilly and criminally, with respect to an important and recurring issue.

The imposition of criminal liability based on the complicated transactions at issue in this case is inappropriate. As the Second Circuit has noted:

> [O]ne of the most esoteric areas of the law is that of federal taxation. It is replete with 'full grown intricacies', and it is rare that a 'simple, direct statement of the law can be made without caveat'.

United States v. Regan, 937 F.2d 823, 827 (2d Cir. 1991) (*quoting* 1 *Mertens Law of Federal Income Tax* § 1.01), *cert. denied sub nom.*, 112 S. Ct. 2273 (1992).

The defendants in this interest deduction case have been held criminally accountable, not to the clear rule of the Tax Code, but to one of several competing interpretations of Section 163.

Criminal liability is unduly and impermissibly harsh "when the law [is] uncertain or cast in doubt by prior court decisions." *United States v. Heller*, 830 F.2d 150, 155 (11th Cir. 1987). *See United States v. Garber*, 607 F.2d 92 (5th Cir. 1979); *United States v. Critzer*, 498 F.2d 1160 (4th Cir. 1974).

The tax issue boils down to whether the statutory requirements for an interest deduction as stated in the Code (genuine debt and accrual of interest) are sufficient for an interest deduction, which is the rule in the Fourth, Sixth, and Tenth Circuits, or whether the statutory requirements are necessary but a subjective non-tax purpose such as a profit motive is also required for an interest deduction under the contrary rule in the Second Circuit.

The interpretation of any statute "must begin with the language of the statute itself." *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979). This Court has also cautioned that the literal terms of a tax statute should be ignored "only under rare and exceptional circumstances." *Crooks v. Harrelson*, 282 U.S. 55, 60 (1930). Section 163 provides as a general rule that "*all* interest paid or accrued within the taxable year on indebtedness" is deductible, subject to certain statutory exceptions that are not relevant here. IRC § 163(a) (emphasis added). The requirements for deductibility under Section 163(a) are plain and unambiguous: (1) payment or accrual of interest; and (2) actual indebtedness. *See Stanton v. Commissioner*, 34 T.C. 1, 7 (1960) ("Congress has included no requirement in the Code that the borrowed money be used in connection with a transaction entered into for profit . . . Congress has repeatedly considered and ultimately rejected limitations somewhat comparable to the [requirement] now urged by the Commissioner").

The Fourth, Sixth, and Tenth Circuits follow the plain meaning and clear rule of the statute. In *Rice's Toyota World, Inc. v. Commissioner*, 752 F.2d 89 (4th Cir. 1985), a case involving the sale and leaseback of computers, the Tax Court had denied a deduction for interest paid on recourse debt that had been used to finance the sale-leaseback because the underlying transaction was motivated by no business purpose other than obtaining tax benefits and had no reasonable prospect of providing

a profit and was, therefore, a sham. The Fourth Circuit reversed on the interest deduction issue despite "the sham nature of the underlying purchase transaction" because the debt was real and interest was paid. *Id.* at 96.

The Fourth Circuit rule as set forth in *Rice's Toyota* finds sufficient economic substance for an interest deduction in the satisfaction of the statutory requirements of genuine debt and the payment or accrual of interest. In *James v. Commissioner*, 899 F.2d 905 (10th Cir. 1990), the Tenth Circuit followed *Rice's Toyota* and approved an interest deduction on genuine debt despite the fact that the underlying transaction was a sham and, therefore, could not be respected for tax purposes. In so holding, the *James* court said, "[w]e agree [with *Rice's Toyota*] that within the framework of a sham transaction a taxpayer may incur bona fide obligations which should be recognized for tax purposes." *Id.* at 910. In *Smith v. Commissioner*, the Sixth Circuit relied on the *Rice's Toyota* rule to conclude that the taxpayer's payment of interest on a "genuine obligation" gave rise to a valid tax deduction "even in the face of the sham nature of the underlying agreement." 937 F.2d 1089, 1099 (6th Cir. 1991). The Tax Court has also adopted the Fourth Circuit's reasoning:

> [W]e believe that the distinction made by the [Fourth Circuit] Court of Appeals is valid *to the extent that the petitioners actually incurred a debt . . . that was certain to be paid* . . . [I]n other words, the requirement of a profit objective is not one of the limitations in section 163 on the deduction of interest actually paid.

Rose v. Commissioner, 88 T.C. 386, 423 (1987) (emphasis added), *aff'd on other grounds*, 868 F.2d 851 (6th Cir. 1989).

In this criminal case, the Court of Appeals has embraced a standard for interest deductions which is not supported by the statute and is stricter than the standard which the Fourth, Sixth, and Tenth Circuits have applied in civil cases. The Second Circuit now requires that a borrowing must have *additional*

economic substance in the form of a non-tax purpose (*i.e.*, a business purpose other than tax savings) or market risk (*i.e.*, an objective potential for economic gain apart from tax savings).

In *Goldstein v. Commissioner*, 364 F.2d 734 (2d Cir. 1966), *cert. denied*, 385 U.S. 1005 (1967) the Second Circuit first grafted onto the clear statutory language of Section 163 the additional requirement of "purposive activity" in order to claim an interest deduction. The *Goldstein* court acknowledged that "there is no [statutory] requirement that deductible interest serve a business purpose, that it be ordinary and necessary, or even that it be reasonable." *Id.* at 741 (citation omitted). Nevertheless, the *Goldstein* court opined that:

> Congress could not have intended to permit a taxpayer to reduce his taxes by means of an interest deduction that arose from a transaction that had no substance, utility or purpose beyond the tax deduction.

Id. at 742.[9]

The Second Circuit appeared to back away from *Goldstein* in *Jacobson*, in favor of the plain meaning of Section 163: "even if the motive for a transaction is to avoid taxes, interest incurred therein may still be deductible if it relates to economically substantive indebtedness." 915 F.2d at 840. The *Jacobson* court relied on Tax Code Sections 183(b)(1) and 163(a) to conclude that interest expense deductions are not dependent on a finding of a non-tax purpose and that an interest deduction is "allowable . . . without regard to whether or not such activity is engaged in for profit." IRC § 183(b)(1) (1988); *Jacobson*, 915 F.2d at 840. In this case, by adding the element of a non-tax purpose, the Second Circuit has rejected *Jacobson* where it had followed the clean contours of the statute.

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[9] The *Goldstein* rule has been criticized by tax commentators because of its departure from the clear language of Section 163 and basic principles of statutory construction. Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. Chi. L. Rev. 859, 875-76 (1982); John H. Young, *The Role of Motive in Evaluating Tax Sheltered Investments*, 22 Tax Law. 275, 279-81 (1969).

This case is an appropriate vehicle for the resolution of the conflict among the circuits because the trial court's confusion on the economic substance requirement infected the jury's understanding of the requirement of an actual debt. The jury was charged that it could not find that the repo loans represented genuine debt unless it found that the loans possessed "substance or business purpose", and that they would be fraudulent for "tax purposes" if they lacked "economic substance". (Appendix E-12). The trial judge also charged that the repo transactions possessed economic substance if they had business purpose or market risk. (J.A. 1635). These errors would have affected the jury's response to the special interrogatory. A finding that the transactions were "fictitious" could have been based on the erroneous instruction that a transaction without "economic substance" is "fraudulent". (J.A. 481).

Consistency among the circuits and certainty in the administration of the tax laws are essential, particularly when the law can form the basis of a criminal indictment.

CONCLUSION

For the foregoing reasons, petitioner Bernhard F. Manko respectfully requests this Court to grant this Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit, and to reverse the conviction of petitioner Bernhard F. Manko.

Dated: New York, New York
March 4, 1993

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 1600, 1601—August Term 1991

(Argued July 13, 1992 Decided October 9, 1992)

Docket Nos. 91-1732, -1733

UNITED STATES OF AMERICA,

Appellee,

—v.—

BERNHARD FRED MANKO, also known as Fred;
and JON EDELMAN,

Defendants-Appellants.

Before:

ALTIMARI, MAHONEY, and WALKER,

Circuit Judges.

Appeal from judgment of conviction entered in the United States District Court for the Southern District of New York (Mary J. Lowe, *Judge*) on ground that district court's bias denied defendants a fair trial.

Affirmed.

EARL H. NEMSER (Kathryn L. Hoenig, Gary J. Mennit, Burton Spivak, Cadwalader, Wickersham & Taft, New York, NY, of counsel) *for Defendant-Appellant Manko.*

MARION BACHRACH (Carro, Spanbock, Kaster & Cuiffo, New York, NY, of counsel) *for Defendant-Appellant Edelman.*

ROBERT J. CLEARY, Ass't U.S. Atty, Southern District of New York (Otto G. Obermaier, U.S. Atty, Miguel A. Estrada, Daniel C. Richman, Ass't U.S. Atty's, Southern District of New York, of counsel) *for Appellee.*

WALKER, *Circuit Judge*:

On February 4, 1991, following a four-month jury trial in the Southern District of New York before Judge Lowe, Bernhard Fred Manko and Jon Edelman were convicted of making and subscribing false tax returns in violation of 26 U.S.C. § 7206(1), aiding and abetting in the preparation of false returns in violation of 26 U.S.C. § 7206(2), and conspiring to violate the tax laws and to defraud the United States in violation of 18 U.S.C. § 371. On November 25, 1991, the district court sentenced each defendant to five years imprisonment and fined each $450,000. On appeal, Manko and Edelman raise a host of objections to the district court's conduct of the trial. In addition, Manko and Edelman assert that the government failed to produce sufficient evidence to sustain their convictions and that prosecutorial misconduct denied them a fair trial.

BACKGROUND

Manko and Edelman were professionals in the once thriving field of tax shelters. In the late 1970s and early 1980s, the two sold interests in partnerships that engaged in complex commodities straddles. These straddles had the effect of creating losses in one tax year and a corresponding gain in the subsequent year, thereby deferring income. *See Gardner v. Commissioner*, 954 F.2d 836 (2d Cir.) (per curiam), *cert. denied sub nom. Falk v. Commissioner*, 112 S.Ct. 1940 (1992).

The straddle business evaporated when Congress passed the Economic Recovery Tax Act of 1981 ("ERTA"), Pub. L. 97-34 (1981). ERTA eliminated the tax benefits of straddles by requiring the taxpayer to recognize both the gain and the loss generated by the straddle in the same tax year. Manko and Edelman began to look for new tax deferral techniques.

Eventually, Manko and Edelman devised a way around ERTA. They determined that by engaging in repurchase transactions ("repos") in United States Treasury Bills ("T-Bills"), they could create interest deductions in the first tax year and corresponding gains in the second year, with little or no risk. A T-Bill is an obligation of the United States Government to pay a fixed amount (the face value) at a certain date in the future (maturity). T-Bills are purchased at a discount from face value. The interest is determined by the difference between the face value and the purchase price. A repurchase agreement is an agreement to sell a T-Bill and then repurchase the bill at a later date for a predetermined amount. In effect, a repurchase agreement is a loan in the amount of the proceeds of the original sale, collateralized by the T-Bill, with interest equal to the difference between the sale and repurchase prices. A repurchase agreement may expose the parties to market risk, since the agreed-upon repur-

chase price may be greater or less than the market price of the T-Bill at the agreed-upon date. A repo to maturity exists when the repurchase date specified in the agreement is the maturity date of the T-Bill. In a repo to maturity, there are no economic variables, since the market value of the T-Bill at maturity is always equal to the face value of the T-Bill.

Repos created tax advantages because, until the tax laws changed in 1984, a securities dealer could deduct the interest payments on the loan as they accrued, but only had to report the corresponding gain from the appreciation of the T-Bill at maturity. If the T-Bill matured in the tax year after the repurchase agreement was made, the taxpayer would be able to defer income equal to the amount of interest accrued in the first year.

One problem with using repos to create tax deductions is that the deduction created in the first year is relatively small compared with the face value of the T-Bill. A repo on a ten million dollar T-Bill would only create a few hundred thousand dollars of interest deductions. Since Manko and Edelman had raised over $25 million from investors with a promise of generating four times that amount in tax deductions, they realized they would have to do huge quantities of repos to maturity.

At trial, the government asserted that Manko and Edelman hatched a fraudulent scheme in order to achieve such volumes. The government alleged that Manko and Edelman appropriated a dormant shell company, TSM Holding Company ("TSMH"), and unilaterally wrote documents to reflect billions of dollars of repos to maturity between TSMH and two clearing brokers controlled by Manko and Edelman—Government Clearing Company and Government Securities Trading Corporation (collectively "GCC"). In turn, Manko and Edelman created documents to reflect mirror transactions

between GCC and several investment partnerships, thereby passing on the ersatz tax breaks to numerous unwitting investors. Manko and Edelman represented to their lawyers and accountants that TSMH was an independent entity and that all their transactions with TSMH actually occurred and carried market risk.

The documents introduced at trial described the trades as follows. First, TSMH would sell a T-Bill through GCC to the partnerships. Since TSMH was only a shell company without assets, TSMH would sell the bill short. In a short sale, a party sells a security that it does not own and must therefore find a way to deliver the security to the buyer, such as borrowing it from a third party. Since TSMH sold as much as a billion dollars worth of T-Bills at a time, the partnerships lacked the funds to pay for the T-Bills. Accordingly, the partnerships would borrow the funds from GCC by entering into a repo to maturity with GCC secured by the T-Bill received from TSMH in the short sale. GCC, of course, did not have a spare billion dollars lying around to lend to the partnerships. Instead, GCC would borrow the funds from TSMH with a repo to maturity secured by the same T-Bill that TSMH had sold short to the partnerships and that the partnerships had loaned to GCC.

The return of the T-Bill to TSMH as collateral cancelled TSMH's obligation to deliver the T-Bill promised in the short sale. Therefore, at the end of the day, GCC would owe TSMH the proceeds of the loan plus interest and TSMH would owe GCC a T-Bill. Both obligations would come due at maturity. GCC would have mirror obligations with the partnerships. The terms of the repurchase agreements between GCC and TSMH exactly mirrored the terms of the agreements between GCC and the partnerships. At the end of the first tax year, GCC would "roll up" the outstanding interest payments on the loan by unilaterally adding them to the principal amount

of the loan. The mirror transactions between GCC and the partnerships would proceed with a similar interest roll up, thus allowing the partnerships to take the tax deductions.

GCC set the interest rates on both loans so that the loan proceeds plus interest would exceed the face value of the T-Bill by a set amount—$50 per million at the outset. This money, in effect TSMH's fee for providing GCC with a tax deduction to pass on to the partnerships, was the only thing actually to change hands in the transactions.

The government presented a substantial amount of evidence that the transactions described above never took place—that GCC engaged in typing, not trading. First, from July of 1982 to September of 1982, there was no one at TSMH with whom Manko and Edelman could negotiate the deals. Vincent Tese and James Sinclair (former partners of Manko) set up TSMH in June of 1982. Neither, however, ever injected any capital into TSMH or used the company in any way. Both denied any knowledge of the transactions between TSMH and GCC. During this period in which nobody controlled TSMH, Manko and Edelman had their trading room staff write up trade tickets that made it appear that TSMH had sold $500 million in T-Bills to GCC and loaned GCC the money to purchase them. GCC prepared but did not send confirmations reflecting the terms of these trades. Edelman admitted that GCC determined the size of the transactions and set the interest rate on the repo without negotiating with TSMH.

In October of 1982, perhaps in an effort to provide more substantial documentation of the "trades," defendant Manko hired Richard Bandel, a former employee of GCC, to work at TSMH. At Manko's instruction, Bandel picked up the confirmations that GCC had printed and logged into accounting ledgers all the trades that had been written up to that point.

With Bandel in place at TSMH, GCC began sending trading confirmations to TSMH, and Bandel logged these transactions into TSMH's books. The defendants admitted that even with Bandel in place, GCC did not negotiate the terms of the transactions with TSMH.

At about the same time that Manko placed Bandel at TSMH, Tese and Sinclair transferred TSMH, free of charge, to Robert Maurus and Charles Genovese. Maurus testified that he did not even learn that Bandel worked at TSMH until March of 1983. Genovese testified that Manko informed him that TSMH needed Bandel in order to make TSMH "look like a real company."

After the transfer, Maurus and Genovese remained largely unaware of the details of the alleged transactions. On redirect examination, Maurus conceded that he understood nothing about the transactions except that GCC wrote up the paper and TSMH received a fee. It was not until the Spring of 1983 that TSMH began to send reciprocal confirmation slips to GCC. By the time these confirmation slips were sent, most of the underlying T-Bills had already matured and the parties' obligations had already been settled. Genovese testified that these confirmation slips were sent for "cosmetic" reasons.

The pace of the transactions accelerated in November of 1982. Faced with the need to create almost $100 million in deductions by the end of the year, Edelman ordered John Mann, the chief trader for GCC, to write up $500 million and $1 billion transactions with TSMH. Edelman instructed Mann to set the price without contacting TSMH. Mann refused, with the explanation that he did not participate in transactions in which he did not speak to the other party. Eventually, Mann agreed to limited participation in the transactions, informing other trading room employees of the market price for T-Bills so that the correct amounts could be written on the trade tickets.

One GCC trading room employee testified:

> Right after the first billion dollars was decided on, it was just quiet right after, and then Joe Bryant [a trading room employee] said "this is the one that's going to get them." And John Mann and [another employee] and myself all agreed to that, and a few minutes later John Mann said, "it's gone too far now. The boys have gone too far."

At other times, trading room employees referred to the billion-dollar trades as "the straw that's going to break the camel's back." Employees also discussed the financial reward for turning Manko and Edelman in to the IRS.

After the first three days of the billion dollar trades, Mann informed Edelman that he "had legal reservations about these trades and didn't want to do them anymore." Mann testified that Edelman replied that the trades were "none of [Mann's] concern" and "that it was not [Mann's] job to be policeman for the world."

In fifteen days in November of 1982, GCC wrote $25 billion worth of T-Bill repurchase transactions with TSMH. After that, the pace of the scheme slackened, but GCC continued to write repurchase transactions until the tax laws changed in 1984. At the time of the billion dollar trades in November of 1982, TSMH had $33 in cash, $50 in office expenses, and no telephone bills. TSMH did not even have a bank account until the end of that month.

Eventually, Barbara Kanter, Edelman's personal assistant, opened an account for TSMH. Kanter then transferred millions of dollars into and out of TSMH's account. The defense alleged at trial that this money reflected interest payments from GCC to TSMH. However, Edelman acknowledged on cross-examination that he could not correlate any particular payment to interest owed on any loan. When Maurus and Genovese learned in the spring of 1983 that Kanter had been

transferring money into and out of their account, they made no efforts to stop her. Genovese explained at trial that he felt the money did not belong to TSMH.

Faced with this powerful evidence that the purported transactions were shams that never took place, the defense contended at trial that TSMH had granted GCC discretion to make trades on TSMH's behalf, and thus that there was no need for GCC to seek TSMH's approval of the terms of the repo transactions. The defense never presented any direct evidence of such an agreement apart from Edelman's testimony that Manko told him that TSMH had granted GCC discretion to make trades.

The defense further argued that there was nothing strange about a corporation with no assets making billions of dollars of loans because it was common in the government securities markets for undercapitalized entities to engage in highly leveraged, low-risk transactions.

The trial also proceeded on a second front. The government argued that even if the jury were to determine that the transactions actually occurred, the transactions were devoid of risk and thus lacked economic substance. Accordingly, the government contended that the transactions could not form the proper basis for tax deductions. The defense countered that so long as the repurchase loan represented a real debt, interest paid on that debt could be deducted even if the transactions as a whole lacked economic substance. The court sided with the government and charged the jury that it could convict if it found either that the transactions did not occur or that they lacked economic substance.

The trial in this extremely complex matter took four months. At the close of trial, the jury convicted Manko and Edelman on all counts. After the jury returned the verdict, the district court gave the jury a supplemental interrogatory that

asked the jury to indicate whether it concluded that the transactions never took place or that the transactions lacked economic substance. After deliberating briefly, the jury announced that it had determined that the transactions never took place. This appeal followed.

DISCUSSION

On appeal, Manko and Edelman principally challenge the district court's handling of the trial. They contend that the court questioned witnesses in a way that suggested disbelief of the defendants' position, improperly held an *ex parte* conference with the prosecutor near the end of the trial, permitted the prosecutor to make improper comments in summation, and issued confusing instructions to the jury. Defendants suggest that the combined force of these asserted infirmities denied them a fair trial.

A. The Trial Court's Conduct

The district judge took an active role in the trial of this case, asking numerous and probing questions of witnesses. Such conduct is unquestionably proper—indeed, often required—in extremely complex cases. *United States v. Gurary*, 860 F.2d 521, 527 (2d Cir. 1988), *cert. denied*, 490 U.S. 1035 (1989); *United States v. DiTommaso*, 817 F.2d 201, 221 (2d Cir. 1987); *United States v. Pisani*, 773 F.2d 397, 403 (2d Cir. 1985). However, such questioning carries with it the risk that the judge will appear partial to one side or the other. In order to avoid the appearance of partiality, a trial judge should limit questioning to inquiries necessary to clarify ambiguities, correct misstatements, or obtain information necessary to make rulings. *United States v. Mazzilli*, 848 F.2d 384, 388 (2d Cir. 1988).

The fact that a judge asks a question the purpose of which is not so limited will not always require reversal. Judges are

human, and it is inevitable that in the course of long, complex, and hotly contested trials, a judge may on occasion react intemperately. A defendant is not entitled to a perfect trial, only a fair one. *United States v. Robinson*, 635 F.2d 981, 984 (2d Cir. 1980), *cert. denied*, 451 U.S. 992 (1981). Our ability to discern from a cold record whether particular statements of a trial judge rendered the trial unfair is quite limited. "[I]t is difficult to glean tone of voice, whether sarcastic or neutral, facial expression, whether reflecting disbelief or sober thoughtfulness, or physical demeanor, whether self-contained or expressing opinion and emotion. Therefore, it is only after an examination of the entire record that we can come to a conclusion about the conduct of the district court." *Mazzilli*, 848 F.2d at 389 (2d Cir. 1988).

The defendants point to several incidents in the trial that we quite frankly find disturbing. Nonetheless, after a careful review of the entire record, we conclude that the district court's conduct did not deny defendants a fair trial.

1. *The District Court's Questioning of Jon Edelman*

A district court must show particular restraint in questioning a criminal defendant during the defendant's direct testimony. At this critical phase of the trial, the court must scrupulously insure that its questions do not indicate that the court doubts that the witness is telling the truth. *Mazzilli*, 848 F.2d at 388-89; *United States v. Victoria*, 837 F.2d 50, 55 (2d Cir. 1988). Impeaching the defendant is the job of the prosecution, not the court.

Here, the district court vigorously interceded in Edelman's testimony. Most of the court's questioning took the form of inquiry into precise details of the transaction. The court repeatedly sought to clarify whether GCC had made certain payments to TSMH in cash or by book entry. While the relevance of this distinction to whether the transactions took

place or had economic substance is not entirely clear, our view upon reading the record is that the court's questions were aimed at pinning down this factual issue, not at casting doubt on defendant Edelman's credibility. Accordingly, we think this portion of the court's questioning of Edelman was proper.

We are more troubled by the court's questioning of Edelman with regard to financing arrangements between GCC and the investor partnerships. At one point, Edelman compared GCC's willingness to enter into a repurchase agreement with an investor partnership to allowing a customer to purchase securities on margin. The court asked a series of questions that undermined the analogy:

> [Edelman]: Yes, there is financing here and the best analogy I could make simply is to a financing on a margin account where you might have 100 shares of IBM you paid for, no money in your account, but fully paid for and you want to buy another 100 shares. You can do that.
>
> The Court: Yes, you can, but if it's called you are expected to pay.
>
> Edelman: If there is a margin call.
>
> The Court: Yes.
>
> [Edelman]: And the same thing is here, if my equity declines —
>
> The Court: At any time in these whole 2 years we are talking about, did GCC or TSM ever call upon any of these partnerships to put money on any of these financing transactions?
>
> [Edelman]: Can I answer that generically first?
>
> The Court: Any way you want to.

[Edelman]: When an account at GCC has deficit equity, that is, that its value is less than the amount that it has borrowed, it has deficit equity, then GCC would be in a position to ask for more money. It may ask for more money, it may not.

The Court: That isn't my question. This is 1990. We are seven years down the road of the last transaction. In any of those two years, '82 or '83, did GCC or TSM ever ask any of these partnerships to put up money such as you were talking about a margin call in a stockbroker's account?

[Edelman]: With respect to the financing repo to maturity transactions, no other transactions?

The Court: Yes.

[Edelman]: I don't think so. GCC would be the person who would ask for money and I don't recall any situation where that was required.

[The Court]: That is the question I was asking.

By forcing Edelman to concede that GCC never made a margin call, the court discredited Edelman's analogy to ordinary brokerage accounts. By undermining Edelman's testimony in this fashion, the court may have cast some doubt on Edelman's credibility. We note, however, that the court's questioning related to a collateral issue and that Edelman's lawyer, upon resuming questioning, elicited testimony explaining that GCC would never need to make a margin call because the securities held as collateral for the repos, the T-Bills, were by their very nature always increasing in value as maturity approached. Thus, any doubts raised by the court's questions were quickly dispelled. While the court should not have challenged Edelman's analogy, since the challenge reflected as much on credibility as it did on factual

clarification, we do not think this incident undermined the fairness of the trial.

2. *The Bandel Cross-examination*

We are also disturbed by the district court's conduct during the cross-examination of Richard Bandel, who testified for the government. The government's theory was that Bandel had been placed in TSMH by Manko to record the paper transactions in TSMH's books and that Bandel had no substantive role in determining the dimensions of the transactions.

The defense sought to discredit the government's view of Bandel's role in several ways. First, the defense asked Bandel to explain his testimony that Manko had hired him at TSMH in light of Bandel's prior statement in an affidavit that someone other than Manko had hired him to work at TSMH. Bandel, with some prodding from the district court, indicated that he stood by his testimony in court and that his present recollection was more accurate than that found in his prior affidavit. The defense also asked Bandel about his view of the transactions, perhaps in an effort to show that Bandel had some role in negotiating the deals:

> Q. [The Prosecutor] asked you about the large trades that occurred in November of 1982.
>
> A. Yes, he did.
>
> Q. And it's your testimony that you viewed those trades no differently than any others?
>
> A. Just that I was told—
>
> The Court: By whom?
>
> The Witness: By Joe Bryant, usually the day before I would get the ticket, that there were large tax trades going through.

Q. And it's fair to say the word "tax trade" was used openly?

A. Yes.

Q. And that based on your experience on Wall Street that many trades had a tax component?

Mr. Robinson: Objection.

The Court: This man was a scrivener, he wasn't a policy maker.

While prosecutor Robinson's objection was well taken, in that Bandel had not been qualified as an expert, the court's observation that Bandel "was a scrivener" was unnecessary and prejudicial. The government's theory was that Bandel was a scrivener, and evidence in the record supports this view. The district court, however, should not have endorsed the government's position.

The court repeated the error moments later:

Q. Did you ever tell Mr. Maurus or Mr. Genovese that you had any problems with these trades?

The Court: He has told us that when he found there might be errors, he spoke to Mr.—who did you speak to about the errors in calculating the fees?

The Witness: The financing, Joe Bryant.

The Court: And Mr. Bryant and you got together and corrected whatever errors?

The Witness: Yes.

Q. My question was, did you ever tell Mr. Maurus or Mr. Genovese, when they took control of TSM Holdings, that you had any problems or concerns about these trades?

> The Court: What kind of problems are you talking about? The man was a scrivener. That's the third time I repeated it. He knew nothing about the underlying transaction, and you're not going to ask questions to give the inference that he did when he has told you repeatedly he did not know.

The court thus explicitly and repeatedly endorsed the government's view of Bandel's role. Such a breach of impartiality is a matter of grave concern.

We cannot, however, conclude that the court's conduct denied Manko and Edelman a fair trial. First, defendants did not argue to the jury that Bandel negotiated the transactions. In closing argument defendants all but adopted the court's characterization, impeaching the accuracy of Bandel's testimony by stressing that after leaving Wall Street, Bandel went to work as a part-time starter at a golf course. Thus, defendants do not really dispute the accuracy of the scrivener label.

Second, the court properly instructed the jury that the jury's view of the evidence controlled, regardless of what the court said:

> With respect to factual matters, it is your recollection that controls. Nothing that counsel for either the government or the defendant may have said with respect to matters of evidence, either in their openings or in their summations, is evidence in this case; nor are any remarks that I may make during the course of this charge, or have made during the course of the trial—hat is not evidence.
>
> * * *
>
> I remind you again that nothing I may have said, even my questions to witnesses during the trial when they were on the stand, those questions should be given no

> undue weight for their sole purpose was to clarify and aid you in understanding what the content of the testimony was to be. So you are to place no undue weight, one way or another, on the fact that I may have asked questions of witnesses.

In light of this extensive instruction and the fact that the court's statement concerned what proved to be an uncontested issue, we do not think that the court's error denied Manko and Edelman a fair trial.

In sum, our review of the transcript confirms that on a few occasions the court crossed the line in questioning witnesses. In the context of a four month trial, we think the court's conduct did not indicate to the jury that the court believed that the prosecution should win. Accordingly, we reject defendants' contention that the trial court's conduct denied them a fair trial.

B. The *Ex Parte* Conference

Towards the end of the government's summation, one prosecutor initiated a conference with the district court, without the defense team. The conference was transcribed, but the district court sealed the record of the conference and refused to unseal the transcript until after the government's rebuttal summation. In this *ex parte* conference, the prosecutor advised the district court of his plan to use a chart in the rebuttal summation:

> The Court: What is it you have handed me, Mr. Cleary?
>
> Mr. Cleary: Judge, I just handed you a document I typed up headed "Excerpts of testimony." It lists witness's names and either quotations or paraphrases of their testimony. It's what I propose to use. It's a mockup of a chart I propose to use in my rebuttal summation.

I bring this to you ex parte because I didn't want to let the defense know at this time before they sum up exactly what I am proposing to do in my rebuttal and I did want to apprise the court that I am planning on doing this so that your Honor could allot whatever time is necessary between the end of the last defense summation and the beginning of the rebuttal summation should there be objection to this. Because at that time I propose to give the defense a copy of this mockup which contains references to the page of the transcript.

I should add, Judge, if you think it's more appropriate to disclose this information to them now, although I prefer not to I, of course, would go along with that.

The Court: No, I don't think you should disclose it. What I will do is I will check the places that you expect to use quotations or summations of testimony with the record so I will be in a position to rule if there are objections to your use.

Mr. Cleary: Thank you, Judge.

The Court: All right.

At the close of the defense summation, the government informed the defense of its intent to use the chart on rebuttal, and the court allowed the defense forty-five minutes to review the twenty-eight quotations and paraphrases in the chart for accuracy. Defendants objected to the use of the chart and requested surrebuttal, but did not point to any specific inaccuracies in the chart. The court overruled defendants' objection and denied the request for surrebuttal. On appeal, the defendants assert that the *ex parte* conference denied them due process.

We note at the outset our inability to fathom why the prosecutor would jeopardize a four month trial with a wholly

unnecessary *ex parte* conference. Such conferences "should not be conducted except in extraordinary circumstances." *United States v. Walsh*, 700 F.2d 846, 858 (2d Cir.), *cert. denied*, 464 U.S. 825 (1983). No such extraordinary circumstances are present here.

The government lamely contends that the conference was for a proper purpose—to advise the district court of the government's plan to use a chart so that the court could allot proper time for argument between the defense summations and the government's rebuttal summation. But if that were all that the government wished to accomplish in the meeting, then there would have been no need to show the court the chart the government planned to introduce. The government could have indicated, with defense counsel present, that it likely would have a chart in rebuttal which would require prior review. The only purpose for showing the court the precise quotes the government wished to use was to enable the court to review the chart for accuracy before the defense had an opportunity to present any arguments to the court. In short, the prosecution initiated this *ex parte* proceeding in a blatant attempt to win a tactical advantage, to get a "leg up." Unhappily, the district court went along with the prosecution.

That this *ex parte* conference was improper and unnecessary does not, of course, establish reversible error. *United States v. Persico*, 349 F.2d 6, 13 (2d Cir. 1965). Rather, "[t]he fact that such a meeting occurs . . . does not require reversal if it does not affect the fairness of the trial." *Walsh*, 700 F.2d at 858; *see also United States v. Moten*, 564 F.2d 620, 630 (2d Cir.), *cert. denied*, 434 U.S. 959 (1977).

Defendants do not point to any inaccuracies in the chart. Nor do defendants identify any way in which the chart went beyond the scope of proper rebuttal. *Cf. United States v. Giovanelli*, 945 F.2d 479, 493-96 (2d Cir. 1991) (Newman, J.,

concurring). Defendants' contention that a chart prepared before the defense summation is necessarily beyond the scope of rebuttal is unpersuasive. The quotations reflected on the charts were all central to the case. The government could easily predict that defense summation would tread the same ground as the quotations. Thus, we are convinced that the district court acted properly in allowing the government to use the chart.

Of course, the propriety of using the chart cannot be the measure of whether the *ex parte* proceeding constituted reversible error. Otherwise, the fact of an *ex parte* proceeding would be irrelevant so long as the court ultimately made the right ruling. Such a rule would not properly reflect our deep distrust for one-sided proceedings. Here, however, two facts convince us that reversal is not required. First, because the chart was clearly accurate and within the scope of rebuttal, there is no reason to believe that the district court would have ruled differently absent the *ex parte* conference. Moreover, even if the conference did influence the judge's decision to allow the chart, in the context of this four month trial, we doubt that this chart highlighting damaging testimony played even a minimal role in influencing the jury verdict. The prosecution presented substantial evidence that the transactions with TSMH never occurred. The chart at issue did not present any new information or any information that could not have been conveyed easily to the jury without the chart. Accordingly, we conclude that this highly improper *ex parte* conference does not constitute reversible error.

C. The Jury Instructions

Defendants raise a series of objections to the court's instructions to the jury. Principally, defendants argue that the court should have given all of the proposed charges submitted to the court by the defense on the afternoon of the charging

conference. Most of the proposed charges concerned tangential legal issues that the government never disputed. In this lengthy trial, the court properly avoided burdening the jury with this extraneous information. Accordingly, we find most of defendants' contentions meritless. Defendants do raise three objections to the charge that warrant discussion.

1. *Ratification*

The defense argued at trial that the transactions between TSMH and GCC were real and binding even if TSMH did not grant discretion to GCC to perform trades, because TSMH subsequently ratified GCC's trading. The district court, as part of a general charge on defense contentions, instructed the jury that "the defendants contend that TSM Holding ratified all transactions by subsequent conduct." The defense requested an additional instruction defining ratification. The court refused to give the proposed instruction. Defendants assert this refusal constitutes reversible error. We disagree.

A court may properly refuse to give a charge that fails to accurately state the law. *United States v. Paccione*, 949 F.2d 1183, 1200 (2d Cir. 1991), *cert. denied*, 112 S.Ct. 3029 (1992). Here, defendants' requested charge stated that TSMH could ratify the acts of GCC "either by sending back confirmations to GCC, by failing to object to the transactions after TSMH received confirmations from GCC, or by any other conduct, such as recording the transactions as if they were done, indicating an intention to be bound by the transactions." The problem with this proposed charge is that under New York law, "[a]n agent's acts that are not valid unless performed pursuant to writing can only be ratified in writing." *Weston Associates, Inc. v. Niagara Properties, Inc.*, 130 A.D.2d 964, 965, 516 N.Y.S.2d 381, 382 (4th Dept. 1987). Here, the acts of the purported agent, GCC, contracting for the purchase of securities, would not be valid absent "some

writing signed by the party against whom enforcement is sought." N.Y.U.C.C. § 8-319(a). Accordingly, TSMH could ratify GCC's authority only through a writing. The defendants' proposed instruction suggesting that TSMH could ratify through any conduct indicating an intent to be bound by the transactions failed to state New York law accurately. The district court correctly refused to give the proposed instruction.

2. *Economic Substance*

Defendants claim that they were prejudiced by a reversal by the trial court during the course of the trial on the issue of the proper definition of economic substance. On the eve of trial, the court ruled that if the transactions were not "economically substantive indebtedness," the interest would not be deductible. Defendants claim that the trial court, at this time, rejected a two-part test for economic substance advanced by the government, instead adopting an open definition of economically substantive indebtedness, but then reversed itself in its charge to the jury by adopting the two-part test previously rejected. The two-part test with which the court charged the jury stated, in accordance with our decision in *United States v. Atkins*, 869 F.2d 135, 139-40 (2d Cir.), *cert. denied*, 493 U.S. 818 (1989), that a transaction lacks economic substance if it lacks a reasonable possibility of profit and lacks market risk. Defendants contend that the ambiguous term "economically substantive indebtedness" adopted on the eve of trial would encompass purely formal indebtedness, and that they relied on this notion in presenting their case. The defendants claim that this reversal constitutes a violation of the law of the case doctrine and they were prejudiced by it, since they relied on the earlier ruling in formulating their trial strategy.

While a trial court's reversal of its own ruling during the course of a trial may raise serious issues of prejudice, *see United States v. Uccio*, 940 F.2d 753, 758 (2d Cir. 1991), we doubt whether such concerns are raised here. Our review of the trial record suggests that, at the outset of the trial, the judge's ruling was limited to acknowledging that the question of economic substance was an issue in the case after first saying off the record that it would not be an issue. The judge did not provide the parties with a precise definition of economic substance until her instructions to the jury, when she employed the two-prong test of *Atkins*. On the eve of trial, the judge simply noted that the defense objected to the government discussing profit motive and market risk, but stated to the parties that in establishing whether or not there was economically substantive indebtedness, the parties may present "whatever factors you believe are relevant in order to reach that legal conclusion . . . ." In light of this, the eventual jury charge defining economic substance as profit potential or market risk does not appear to us to constitute a reversal of a prior decision.

In any event, we need not decide whether there was a prejudicial reversal of a prior ruling of law by the trial court. In the special interrogatory, the jury found that the transactions "were fictitious and did not take place." That finding rendered the jury's understanding of the term "economic substance" irrelevant to the outcome.

3. *Prearranged Transactions*

Defendants contend that the court's charge implied that prearranged transactions are necessarily fictitious. Defendants argue that since all repurchase transactions are in some sense prearranged—in that the borrower sells the security to the lender and agrees in advance to repurchase the security at a

later date for a set price—the court's charge effectively forced the jury to conclude that the transactions were fictitious.

Defendants focus particularly on the court's instructions with respect to the knowledge element of the filing false returns charge. The court advised the jury that the government did not have to prove actual knowledge. Instead, the court stated:

> you may find that a defendant knew that the transactions *were a sham* or *without economic substance* if you find, 1, that the defendant you are considering was aware of a high probability that the transactions *did not take place* or *were prearranged* and, 2, that the defendant acted with deliberate disregard for how or whether those transactions were carried out with a conscious purpose to avoid learning the truth on this subject. (emphasis added)

The defendants argue that this charge equated transactions that "did not take place" with transactions that "were prearranged."

However, we think the more natural reading of the above passage is that it equates transactions that "did not take place" with transactions that "were a sham" and equates transactions that "were prearranged" with transactions "without economic substance." Viewed in this light, we doubt the court's instructions prejudiced defendants. Elsewhere in the instructions the court advised the jury that "transactions may be arranged in an attempt to minimize taxes" and expressly stated that in order to lack economic substance, a transaction must "lack[ ] a reasonable possibility of profit apart from tax deductions, and . . . lack[ ] market risk."

More importantly, even if the charge confused the jury on this point, we are unable to see how this confusion prejudiced defendants, for the same reason that we find that defendants could not have been prejudiced by the trial court's alleged

reversal on her instructions on economic substance. As noted above, the jury expressly found that the transactions "were fictitious and did not take place." This response to the special interrogatory removed the economic substance issue from the case. Any lingering confusion about whether prearrangement was synonymous with a lack of economic substance was irrelevant to the verdict. Accordingly, we reject defendants' challenges to the jury instructions.

Finally, defendants assert that the government failed to produce sufficient evidence to support the conviction and that prosecutorial misconduct in summation denied them a fair trial. We have considered these and the remainder of defendants' arguments and find them to be without merit.

CONCLUSION

The trial in this case challenged the resources of the district court. Through the months of testimony and the thousands of documents, the district court grappled with vigorous and experienced defense counsel and diligently struggled to ensure that the jury could follow the evidence and render a fair verdict. Not unexpectedly in a long trial, the court made some mistakes, and defendants did not receive a perfect trial. However, our thorough review of the entire record convinces us that the defendants did receive a fair one.

Affirmed.

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

UNITED STATES COURT OF APPEALS
FILED
DEC 4 1992
ELAINE B. GOLDSMITH, CLERK
SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 4th day of December one thousand nine hundred and ninety-two.

UNITED STATES OF AMERICA,
Appellee,

- v. -

BERNHARD FRED MANKO, also known as FRED; and JON EDELMAN,
Defendants-Appellants.

DOCKET NUMBER: 91-1732, 91-1733

A petition for rehearing containing a sugggestion that the action be reheard in banc having been filed herein by **Appellant Bernhard Fred Manko**

Upon consideration by the panel that decided the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

s/
ELAINE B. GOLDSMITH,
Clerk

by: s/
Chief Deputy Clerk

United States District Court for
SOUTHERN DISTRICT OF NEW YORK
DOCKET NO. S89CR91-01 (MJL)

United States of America vs.

DEFENDANT BERNHARD F. MANKO

JUDGMENT AND PROBATION/COMMITMENT ORDER

In the presence of the attorney for the government the defendant appeared in person on this date ROBERT CLEARY

MONTH	DAY	YEAR
11	25	91

COUNSEL ____ WITHOUT COUNSEL
However the court advised defendant of right to counsel and asked whether defendant desired to have counsel appointed by the court and the defendant thereupon waived assistance of counsel.

__x__ WITH COUNSEL

GERALD R. LEFCOURT
(Name of Counsel)

PLEA ____ GUILTY, and the court being satisfied that there is a factual basis for the plea,

____ NOLO CONTENDERE,

____ NOT GUILTY

FINDING & JUDGMENT There being a finding/verdict of

____ NOT GUILTY. Defendant is discharged

__x__ GUILTY. Defendant has been convicted as charged of the offense(s) of

TITLE 21, SECTION 371
TITLE 26, SECTION 7206 (2)
TITLE 26, SECTION 7206 (2)
TITLE 26, SECTION 7206 (1)

DOCKETED AS
A JUDGMENT #91, 2604
ON 12/5/91

The court asked whether defendant had anything to say why judgment should not be pronounced. Because no sufficient cause to the contrary was shown, or appeared to the court, the court adjudged the defendant guilty as charged and convicted and ordered that the defendant is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for a period of

SENTENCE OR PROBATION ORDER

COUNT I THREE YEARS IMPRISONMENT, A FINE OF $250,000.00 $50.00 SPEC. ASS. FEE

COUNT EIGHT THROUGH TWENTY-EIGHT ONE YEAR IMPRISONMENT AND A $50.00 SPEC. ASS. FEE ON EACH COUNT, SENTENCES OF IMPRISONMENT ARE CONCURRENT WITH EACH OTHER AND CONCURRENT WITH COUNT I.

SPECIAL CONDITIONS OF PROBATION

COUNT THIRTY-ONE ONE YEAR IMPRISONMENT A FINE OF $100,000.00 $50.00 SPEC. ASS. FEE. TO RUN CONSECUTIVE TO SENTENCE ON COUNTS ONE AND EIGHT THROUGH TWENTY-EIGHT.

COUNT THIRTY-TWO ONE YEAR IMPRISONMENT A FINE OF $100,000.00 $50.00 SPEC. ASS. FEE TO RUN CONSECUTIVE TO SENTENCE ON COUNTS ONE, EIGHT THROUGH TWENTY-EIGHT, AND THIRTY-ONE.

ADDITIONAL CONDITIONS OF PROBATION

In addition to the special conditions of probation imposed above, it is hereby ordered that the general conditions of probation set out on the reverse side of this judgment be imposed. The Court may change the conditions of probation, reduce or extend the period of probation, and at any time during the probation period or within

a maximum probation period of five years permitted by law, may issue a warrant and revoke probation for a violation occurring during the probation period.

The court orders commitment to the custody of the Attorney General and recommends,

COMMITMENT RECOMMENDATION

It is ordered that the Clerk submit a certified copy of the judgment and commitment to the U.S. Marshal or other qualified officer

MICROFILM
DEC 03 1991 9:00 AM

SIGNED BY

_x_ U.S. District Judge
____ U.S. Magistrate

► HON. MARY JOHNSON LOWE

Date 11-26-91

U.S. DISTRICT COURT
FILED
DEC 2 1994

ORIGINAL PAGE 1

United States Court of Appeals
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,
APPELLEE,

v.

BERNHARD FRED MANKO and JON EDELMAN,
Use short title
DEFENDANTS-APPELLANTS.

Each motion must be accompanied by a supporting affidavit.

91-1732, 1733
Docket Number

NOTICE OF MOTION

state type of motion
for Stay of the Issuance of the Mandate

MOTION BY: *(Name, address and tel. no. of law firm and of attorney in charge of case)*

Earl Nemser, Esq.
Cadwalader, Wickersham & Taft
100 Maiden Lane
New York, New York 10038

Has consent of opposing counsel:		
A. been sought?	☒ Yes	☐ No
B. been obtained?	☐ Yes	☒ No
Has service been effected?	☒ Yes	☐ No
Is oral argument desired?	☐ Yes	☐ No
(Substantive motions only)		
Requested return date:		
(See Second Circuit Rule 27(b))		
Has argument date of appeal been set:		
A. by scheduling order?	☐ Yes	☐ No
B. by firm date of argument notice?	☐ Yes	☐ No

C. If Yes, enter date: not applicable

Judge or agency whose order is being appealed:

UNITED STATES COURT OF APPEALS
FILED
DEC 10 1992
ELAINE B. GOLDSMITH, CLERK
SECOND CIRCUIT

OPPOSING COUNSEL: *(Name, address and tel. no. of law firm and of attorney in charge of case)*

ROBERT CLEARY, AUSA
Office of the United States Attorney
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New York, New York 10007
(212) 791-1967

EMERGENCY MOTIONS, MOTIONS FOR STAYS & INJUNCTIONS PENDING APPEAL

Has request for relief been made below? ☐ Yes ☐ No
(See F.R.A.P. Rule 8)
Would expedited appeal eliminate need for this motion? ☐ Yes ☐ No
If No, explain why not:

Will the parties agree to maintain the status quo until the motion is heard? ☐ Yes ☐ No

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Brief statement of the relief requested:
Defendants-Appellants seek a 90-day stay of issuance of the Mandate pending application for a writ of certiorari.

Complete Page 2 of this Form

By: *(Signature of attorney)*

/s/ Earl Nemser

Signed name must be printed beneath (by CLS)

Earl Nemser

Appearing for: *(Name of Party)*

Appellant or Petitioner:
☐ Plaintiff ☒ Defendant

Appellee or Respondent:
☐ Plaintiff ☐ Defendant

Bernhard Manko

Date
10/12/92

ORDER

Kindly leave this space blank

IT IS HEREBY ORDERED that the motion be and it hereby is granted ~~denied~~

UNITED STATES COURT OF APPEALS
FILED
DEC 22 1992
ELAINE B. GOLDSMITH, CLERK
SECOND CIRCUIT

/s/

/s/

/s/

12/22/92

* * *

T. 1613

A. I said, "Don't even show me those tickets, I don't want to be hauled out of here in handcuffs."

Q. Did Mr. Bryant reply?

A. He said, "I'm just an employee, and I'm showing you these tickets," and I said, "Well, I don't like seeing tickets anyway."

Q. I want to move onto another subject now.

Had you received any tax benefit from the TSM tax transactions?

A. Had I received any?

Q. Right.

A. I was a participant in some limited partnerships.

Q. Which ones — let's focus on 1982 and '83?

A. In 1982, I was in a limited partnership called AIP, and in a limited partnership called HTA, Hedge Trading Associates, and in one called AHF, Arbitrage Hedge Fund, and joined one in 1982 called Midopco.

Q. Were these all Manko-Edelman partnerships?

A. They were.

Q. Did you receive any tax deductions from your involvement with these partnerships in 1982 and 1983?

A. I did.

Q. In what amounts?

A. My accountant said that I received a hundred thousand tax deduction in '82, and '83, a little more than

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T. 1866

A. Yes, I recall that.

Q. Are you able to say what year that happened in?

A. What I'm able to say, I could tell you what I'm able to say, but in the negative sense, I am not able to say anything but they were a batch of very large tickets that Joe Bryant held up that had some cancelled and corrects associated with them. I can't say when he held those up.

Q. Even the year?

A. If there was another batch of large tickets in another year, I could have confused it.

Q. Are you able to tell us, or do you know, whether those tickets had anything at all to do with the trades that are the subject of this lawsuit?

A. I cannot.

Q. Was the comment made by you intended to communicate a serious message when you saw those trades?

A. It was to rattle Joe Bryant's cage.

Q. You were getting at him, I think?

A. He held up those tickets, I don't like to see tickets, he's showing me tickets, and he had a line from time to time, "I'm only an employee, I'm only an employee," so I said the words, "Don't show me your tickets," or "those tickets," they're not going to haul me out of here in handcuffs."

Q. With the intention to rattle his cage?

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T. 6374

reiterate, we think the charge the court gave is perfect under Cheeks, but the defense would like the following language added and we do not object. The bottom of page 62, the last sentence begins "a person who acts" and we will be adding something at the end. I will read the whole sentence, "a person who acts on a belief or an opinion honestly held is not punishable under the statute merely because that honest belief turns out to be incorrect or," substitution now, "even if you determine that his belief was unreasonable."

MR. NEMSER: On consent.

THE COURT: Put a pin in that for a minute.

Let's talk about what this court was doing in Cheeks.

The court first said that the government must prove beyond a reasonable doubt that the defendant knew of the duty, in our case, to deduct interest only on genuine indebtedness. Paraphrasing the Cheeks court, it went on to say that if the government proves actual knowledge of this duty beyond a reasonable doubt it has satisfied the knowledge component of wilfulness. However, the government must negate the defendant's claim of either ignorance of the law or because of a misunderstanding of the law he has a good faith belief that he was not violating the law.

Now, as I interpret that distillation, that the

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T. 6428-29

Where is this discretion? Oh, Mr. Manko told me that there was discretion. The partners in crime, the partners in this fraud — Mr. Edelman sits there and tells you that Fred Manko told him he had discretion. But then we put the witnesses on the stand who could have given discretion. Mr. Sinclair, did you give

discretion? No. Mr. Tese, did you give discretion? No. Mr. Maurus, you must have given discretion. No. Oh, then it must have been you, Mr. Genovese, you gave the discretion. No.

Who gave this discretion? Is any authorization form filled out by TSM Holding, by anyone at TSM Holding over this period? No. You know they had them. They have the authorization forms from other clients. Why don't they have one for TSM Holding showing this discretion to do whatever we want to do? It didn't exist. Do they have an authorization form? No. Do they have a discretion form? No. Do they have a contract? That is what they have. They have a contract between TSM Holding and Government Clearing Company saying this is what we can do. We, GCC, at our own discretion, give billions of dollars from you, TSM, and we will set the interest rates.

Where in the real world does that happen? Try on your leisure time and go to the bank and say, ladies and gentlemen, Mr. Citibank, Mr. Chemical Bank, Ms. Bank of America, I am going to borrow money from you. I am going to tell you how much I am borrowing from you and — and here is the trick — I am going to set the interest rate. Who would ever do that? Does that happen in the real world?

It only happens in the Manko world, in the land of Edelman. That is the only place it happens. They do it without a written contract. They do it without powers of attorney. They do it without discretion forms. Are these understandings written down anywhere? No. Mr. Edelman tells you the understandings are in Fred Manko's head. That is where it is.

Mr. Edelman says, but you didn't know this happened because there was this account opening document. TSM filed an account opening document. First of all, even if they did, so what? Does that account opening document have discretionary language in it? No. It says we opened an account. But then he tells you TSM has this account opening document. Mr. Edelman, where is the document? Oops, we lost it. Our biggest customer, we sold 27 billion dollars in securities for them, we borrowed 13 billion dollars, the only document we have, we lost it.

Would any businessman or businesswoman act the way these guys did? Would any businessman or woman act the way Maurus or Genovese did? Of course not. What if a disagreement arose between TSM and GCC? How do you solve it? What do you do? You put on Mr. Manko and Mr. Manko

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T. 6516

that, he doesn't even say I assumed, he says Mr. Bandel was being supervised by Ed Cohen. He knows it doesn't make any sense that they don't talk to this guy.

Remember redirect, I got up and said, wait a minute, did you tell Mr. Bandel he was being supervised by Ed Cohen? No. Did Ed Cohen tell you he was supervising Mr. Bandel? No. Did Bandel tell you that Ed Cohen was supervising him? No. Did you ever see the two of them talking? No. Why do you say that? He finally backs up, and says, yes, I guess I have no reason to say that. Why did he say that? Bandel told you that. He said Cohen was not his supervisor. He said Manko was.

Cohen told I you he didn't supervise Dick Bandel. How is any of this real? You constantly have to ask yourself against these facts, do real business men and women operate this way? What entities out there lend 13 billion dollars in this fashion?

I keep saying that number because I think one gets numb to the numbers involved here. That would have made TSM Holding one of the largest loan institutions in this country. 13 billion dollars in less than six months. That's a tremendous operation. Who are these guys? They don't keep records.

The one guy they got keeping records, he doesn't know what he's doing. He tried to explain this to you. He

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T. 6579 SEALED

want to apprise the court that I am planning on doing this so that your Honor could allot whatever time is necessary between the end of the last defense summation and the beginning of the rebuttal summation should there be objections to this. Because at that time I propose to give the defense a copy of this mockup which contains references to the page of the transcript.

I should add, Judge, if you think it's more appropriate to disclose this information to them now, although I prefer not to I, of course, would go along with that.

THE COURT: No, I don't think you should disclose it. What I will do is I will check the places that you expect to use quotations or summations of testimony with the record so I will be in a position to rule if there are objections to your use.

MR. CLEARY: Thank you, Judge.

THE COURT: All right.

(Continued on next page)

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T. 6612

are holding money for them. What are these guys talking about? He files a tax return. He has $33 in cash, 5 billion dollars in assets. Talk about being liquid cash poor. This is ridiculous. What company is like that? No company is like that.

The evidence of this fraud is overwhelming. GCC and TSM are both controlled by Manko and Edelman. They are the emperors, ladies and gentlemen, but we are in the Federal Court today and all of us are equals here.

You need to look at Manko and Edelman with clear eyes. They are not the emperors here. Look at Manko and Edelman and you tell them that this was a fraud. You know it was a fraud and they knew it was a fraud.

The emperor has no clothes. Mr. Manko, Mr. Edelman, the emperor has no clothes.

Thank you.

THE COURT: Jurors, we will take a recess and then we will begin the summation of Ms. Chepiga.

(Recess)

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T. 6824

I won't have time, because I am sure my secretary will not be happy if I tell her to do this page over tonight. But if you will just make that change on yours.

MS. HOENIG: The first sentence of that paragraph, yesterday we discussed the change to be made there. Just to be clear, was the change made or not made?

THE COURT: Yes. If I can get upstairs in time you might have a clean sheet for tomorrow. I will try, but I can't promise it.

See you tomorrow.

MR. RITHOLZ: Your Honor, I just was shown the transcript for January 29, yesterday, which starts out pages 6578 and 6579 sealed.

MR. CLEARY: That was my conference with your Honor. I don't mind having that unsealed as soon as Mr. Ritholz completes his summation.

THE COURT: All right. Everything I do is on the record one way or another. You will see it as soon as you are finished.

MR. RITHOLZ: You don't think I should know it now before I finish summing up?

THE COURT: No.

MR. RITHOLZ: I won't suffer a prejudice.

THE COURT: The prejudice you will suffer will not be caused by what is sealed, all right?

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T. 6960-61

MR. CLEARY: From the record, the facts the evidence, the testimony under oath of the witnesses.

Mr. Ritholz told us during his summation that the fee was negotiated — the fee was negotiated.

What facts, what evidence, what testimony did he rely on to reach that conclusion? Well, the fee changed, he said — the fee changed. It went from 50 to 5 to 10. Does that mean it was negotiated? Different size trades were done. They weren't negotiated. The facts, the evidence, the testimony shows the fee was never negotiated.

How do we know that? All of the decisions would be made at the Manko/Edelman entities. When we talk about the fee a little bit later we are going to see the fee computed by the difference between the interest income on the bill and the interest expense on the repo. Information that you saw during the course of this trial was typed into the confirmations and someone at the Manko/Edelman offices determined what figures to put on those confirmations, not TSM, not negotiated.

Is this the way real businessmen act, million dollar transactions, billion dollar transactions, no one knowing what is going on, supposedly at risk, having $33 in cash? We have heard a lot about big bucks in this case and I think we all tend to get a little blinded about the type of money we are talking about here. During the course of the last 3 and a half months did you ever stop to think what a billion dollars is, a billion dollars? If I were to hand you a dollar bill every second of every minute of every hour of every day in the entire year, and I never stopped doing that, do you know how long it would take me to give you 1 billion dollars? Any idea?

A JUROR: About 30.

MR. CLEARY: Close, 32 years.

We have in this case, we know, 51 billion dollars in transactions. Mr. Krause told us that. Adding up '82 and '83, do the multiplication, it would take me 1600 years to pass that money over and that is what these defendants did by banging some keys on a typewriter — Maurus and Genovese not even caring what is written with that typewriter and in many instances not even knowing about billion dollar transactions.

There was some discussion by Mr. Ritholz today about an emotional disability that Mr. Maurus had. Mr. Maurus is not emotionally disabled. Mr. Genovese is not emotionally disabled. They are not dumb. They are not stupid. They are co-conspirators with the defendants. They are people that got in bed with the defendants and were willing to do anything the defendants wanted as long as Maurus and Genovese made their money, and they didn't care what was written on the paper. They never reviewed it as

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T. 7040

how much am I going to pay. That is a fee.

Now, they try to dress it up and say, oh, it's a markup just like Mr. McConnon was testifying about, two different things. This fee is a purchase price. It's the amount the defendants determined they would pay in order to get the amount of deductions they determined they wanted, buying tax losses, just like you would buy a loaf of bread at the store. The only difference here is the defendants determined the size of the loaf and how much they are going to pay for it.

How do we know they determined how much they were going to pay? We looked at this earlier. They made all the decisions for both sides.

What do they want you to believe? That it's legal to buy tax losses? If it's legal to buy and sell tax deductions, there would be a "Losses Are Us" franchise on every street corner in this city

and no one would pay a dime in taxes. If it's legal to pay a predetermined fee for a four-to-one write-off, why don't they reveal anywhere that that is what they are doing? If it's legal to do what the defendants did, you, ladies and gentlemen, can eliminate the tax liability of our entire country, and you can do it like that. You go back to deliberate, divide yourselves into 2 groups, jurors in the back row, jurors in the front row.

Jurors in the back row, short, short sale, you

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T. 7042

Ladies and gentlemen, if you really think you can do that, then acquit the defendants. You should acquit the defendants if you think you can do that. But if you think what I just suggested is absolutely ridiculous, and the defendants know that, then it's your duty to convict them.

MS. CHEPIGA: Objection.

THE COURT: Overruled.

MR. CLEARY: Their scheme is even more absurd than the one I just suggested to you. The only difference between what they did and what I suggested to you is the cosmetics. They had more paper. They had more ways to hide things. They lied.

One final point about the fee. The way to hide the fee was to rig the transactions so that GCC's interest expense was always a little higher than the income it got on the bill. Remember, they controlled everything so they can put everything down there. But the very nature of rigging this transaction this way to get the fee — interest expense versus the interest income — shows you that is a phony transaction. I will tell you why.

Remember how Sawyer, Carlock, Mann and even James McConnon, the expert, described real trades, real repurchase agreements. You are on the horn. You are calling around. You finally get a price one place. You try two or three others, you get the best price, call around for financing on

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T. 7126

winks or nods at me." The defense pointed out that Mr. Mann said that everything was aboveboard. There is no question about that. He said it. It's in the record. It's just not believable.

Mr. Mann was not being honest with himself nor with you when he talked about his knowledge of the fraud. He fell prey to one of the most common of human reactions, protect thyself, or as we used to say in the old neighborhood, CYA. He wasn't willing to admit what he knew. Think about it though. Mann was the one who told you how his trading room employees used to refer to these as paper transactions, not having another substance, cosmetics. When Joe Bryant held up the trading documents John Mann expressed concern about being hauled off in handcuffs. "Don't even show me those tickets, I don't want to be hauled out of here in handcuffs."

And he tried to justify that by saying, well, I was just trying to rattle Joe Bryant's cage. It was a joke. If it was a joke, why would it rattle Joe Bryant's cage who was worried about this, the Joe Bryant that we hear replied to Mr. Mann by saying, I am just an employee. I am doing my job. In essence, don't bother me with anything going on here. I am not responsible for this. I am just an employee.

By the way, Mr. Ritholz had pointed out that

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T. 7169 CHARGE

To find a defendant guilty of the crimes charged, in addition to all of the other elements that I will instruct you about, you need only find either, one, that the transactions were a sham, that is, that they never occurred, or the alternative, two, that the transactions lacked economic substance. In other words, either one of these alternatives standing alone, in addition to the elements of the particular crime charged, is sufficient to prove that the transactions were fraudulent for tax purposes and did not give rise to valid tax deductions.

If you find beyond a reasonable doubt that TSM Holding Corporation did not sell the securities to the defendant companies, or did not lend the money to the defendant's companies for the purchase of these securities, I instruct you that you may find that the transactions were a sham or paper tax shelters with form but no substance or business purpose, and therefore did not represent genuine indebtedness.

Now, let's look at the alternative of the government's contentions.

In the alternative, if you find beyond a reasonable doubt that the transactions were without economic substance, that is, that they lacked a reasonable possibility of profit apart from tax deductions, and they lacked market risk, then they would not support interest

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is not sufficient to constitute wilfulness.

You should look at all of the circumstances concerning the transactions involved. Look at the manner in which the transactions were carried out or not carried out and each defendant's knowledge of and role in carrying out those transactions or not carrying them out.

The good faith of the defendant is a complete defense to the tax charges of the indictment because good faith is simply inconsistent with wilfully filing a fraudulent tax return.

While the term "good faith" has no precise definition, it means, among other things, an honest belief and the intent to perform all lawful obligations. A person who acts on a belief or an opinion honestly held is not punishable under this statute merely because that honest belief turns out to be incorrect or wrong. The tax laws subject to criminal punishment only those people who wilfully file a fraudulent tax return.

A person who believes that his tax return truthfully reports the taxable income and allowable deductions under the tax law acts in good faith and cannot be found guilty of wilfully filing a false return. Therefore, the government must prove beyond a reasonable doubt that the defendant you are considering knew that the tax law permitted only the deduction of interest paid on genuine indebtedness and that the defendant did not have a good faith belief that the transactions involved herein constituted genuine indebtedness.

In determining whether or not the government has proven that the defendant wilfully filed a fraudulent tax return, the jury must consider all of the evidence received in the case bearing on the defendant's state of mind.

You are further instructed that motive is irrelevant in determining whether a taxpayer wilfully acted under either Section 7206 subdivision 1 or subdivision 2 of the Internal Revenue Code.

I further instruct you that it is a valid defense to a charge of filing a false return if a person provides full information regarding his taxable income and expenses to an accountant qualified to prepare federal income tax returns and the defendant adopts and files the return as prepared by the accountant without having reason to believe that it is incorrect.

On the other hand, a defendant cannot shift his responsibility to an accountant or another if the defendant has withheld vital information, failed to disclose secret agreements, made false entries in his books, or created false documents or engaged in any conduct the likely effect of which would be to mislead the accountant or to conceal the actual state of his affairs.

* * *

DEFENDANTS' REVISED PROPOSED JURY INSTRUCTION NO. 23

(Specific Criminal Intent)

Under our system of laws individuals are not punished criminally for mere mistakes, negligence, carelessness or errors of judgment, nor are they punished for misunderstanding the law. They are punished only for knowing and intentional wrongdoing.

The defendants here are not on trial for errors of judgment, mistakes, carelessness or for misunderstanding the tax law. They are on trial for criminal offenses, and an essential element of such offenses is the specific criminal intent to violate a known legal duty. To convict either defendant of the charges in the indictment, the prosecution must prove beyond a reasonable doubt that each defendant intentionally violated a known legal duty,

that is that the defendant actually knew of this legal duty and deliberately, consciously, voluntarily and willfully violated that duty.

The government must prove beyond a reasonable doubt that the defendant you are considering actually knew that the tax law prohibited deducting the repo interest expense arising from the transactions between GCC/GSTC and the investment partnerships, and that he voluntarily and intentionally violated the tax law.

In the case of their own returns or the returns of the investment partnerships, a defendant cannot be convicted merely for listing in a tax return an amount of interest expense or loss which is later demonstrated to be wrong. You must find that the defendant you are considering knew of the falsity at the time that he signed and filed the return, and that he did not act merely by accident or through negligence, inadvertence or careless disregard for the truth.

If you find that the defendant you are considering believed that the repo interest expense arising from the transactions at issue in this case was deductible under the Internal Revenue laws, he cannot be guilty of the charges in the indictment, regardless of whether his belief was reasonable.